

Issue Paper Number 00-042



BOARD OF EQUALIZATION
KEY AGENCY ISSUE

- ☐ Board Meeting
- ☐ Business Taxes Committee
- ☐ Customer Services and
Administrative Efficiency
Committee
- ☐ Legislative Committee
- ☒ Property Tax Committee
- ☐ Other

RESULT OF AN AUDIT—SUBJECT TO ESCAPE ASSESSMENT PROPERTY TAX RULE 305.3

I. Issue

How should Property Tax Rule 305.3 interpret the following language from the fourth paragraph of Revenue and Taxation Code section 469: "the result of the audit discloses property subject to an escape assessment"?

II. Staff Recommendation

Staff recommends that Property Tax Rule 305.3 clarify that the language be interpreted to mean a determination in any year of the audit that the net value of any class of property e.g., personal property, improvements, or land, was underassessed.

III. Other Alternative(s) Considered

1. The language means a determination that any individual item of property was underassessed or not assessed at all. (California Taxpayers' Association)
2. The language means a determination that the net total value of all classes of property for all years of the audit was underassessed. (Some County Assessors and County Counsels)

Issue Paper Number 00-042

IV. Background

Under Government Code section 15606, subdivision (c), the Board is given the power and duty to prescribe rules and regulations to govern local boards of equalization and assessment appeals boards when equalizing and county assessors when assessing. Pursuant to that authority, the Board directed staff to draft a new section 305.3 of Title 18 of the California Code of Regulations, Subchapter 3, Local Equalization Property Tax Rules, to interpret provisions of Revenue and Taxation Code section 469 relating to assessment appeal rights and appeals boards' jurisdiction to equalize escape assessments resulting from audits performed pursuant to that section.

Revenue and Taxation Code section 469 requires that a county assessor audit at least once each four years the assessable trade fixtures and business tangible personal property with a full value of \$400,000 or more owned, claimed, possessed or controlled by a taxpayer engaged in a profession, trade, or business. Section 469 further provides in the fourth paragraph:

If the result of an audit for any year discloses property subject to an escape assessment, then the original assessment of all property of the assessee at the location of the profession, trade, or business for that year shall be subject to review, equalization and adjustment by the county board of equalization or assessment appeals board pursuant to Chapter 1 (commencing with Section 1601) of Part 3 of this division, except in those instances when the property had previously been equalized for the year in question.

The paragraph was added by 1978 legislation amending section 469. Prior to the amendment, a taxpayer could only appeal escape assessments following an audit. In a letter to Governor Edmund G. Brown, Jr., dated August 31, 1978, the sponsors of the amendment (the Taxation Section of the California State Bar) expressed the intent of the legislation as follows:

The bill would allow a business taxpayer of property tax to have his entire assessment for a particular year at a business premises to be reviewed and equalized when the assessor by reason of an audit proposes an escape assessment. The bill is needed because many taxpayers do not protest assessments when the overall assessment at a business premises seems fair, even though some components are over-assessed and some under-assessed. Then, years later the assessor by reason of audit, proposes an escape assessment for the under-assessed component. Under the present law, the taxpayer has no redress for the over-assessed component at the late date of the proposed escape assessment.

Thus, the amendment was intended to address situations where:

- A taxpayer was satisfied with an overall property assessment, even while recognizing that he/she was not in agreement with the assessor's allocation to various parts of the overall assessment.
- Subsequently, the assessor conducted an audit that resulted in an escape assessment, thereby increasing the overall assessment for the property for a particular year.
- Following the audit, the taxpayer could only challenge the escape assessment even though the taxpayer had previously recognized that the assessment allocations were incorrect.

A difference of opinion over the application of the foregoing provision has led to the proposal for a new Property Tax Rule to interpret and to make specific its language. Property Taxes Department staff and Legal Division staff drafted proposed Property Tax Rule 305.3 after receiving input from the California

FORMAL ISSUE PAPER

Association of Clerks and Election Officials, California Assessors' Association, County Counsels' Association of California, California Taxpayers' Association, and industry representatives.

On February 25, 2000, staff held a meeting in Sacramento with interested parties for discussions in an effort to reach agreement on as many issues as possible. Staff and interested parties were unable to reach agreement on several key issues and, therefore, it was decided that the rule writing process would be accomplished in two stages.

First, each unresolved issue and the parties' positions on each issue would be presented to the Property Tax Committee for decision. Second, the rule would be redrafted in accordance with the Board's positions on the issues, and then resubmitted to interested parties for review and comment. The redrafted Property Tax Rule would then be presented to the Property Tax Committee for approval of the language.

At the Property Tax Committee meeting on April 5, 2000, the Board was asked to decide five major unresolved issues. However, at the request of some interested parties, the Members decided at the April 5 meeting to delay the rulemaking process until November 1, 2000 because the case of *Heavenly Valley v. El Dorado County Board of Equalization* was pending before the court of appeal. At issue in the case is the proper interpretation of some aspects of the equalization provisions of Revenue and Taxation Code section 469. The oral arguments in the *Heavenly Valley* case are now set for hearing on November 13, 2000.

As instructed at the April 5 Property Tax Committee meeting, staff now requests direction on five major issues surrounding the equalization provisions of section 469 of the Revenue and Taxation Code which will be presented in this issue paper and four other issue papers.

V. Staff Recommendation

Property Tax Rule 305.3 should interpret the language "the result of the audit discloses property subject to an escape assessment" to mean a determination in any year of the audit that the net value of any class of property, e.g., personal property, improvements, or land, was underassessed.

A. Description of the Staff Recommendation

Staff's recommendation is based on the procedures for enrollment of assessments which require the enrollment of the assessed net value of each class of property. Thus, if one class of property within an appraisal unit has been underassessed, then the roll will reflect that value for that class of property has escaped assessment.

To explain the foregoing enrollment procedure, staff recommends that the proposed rule should specify that an audit may disclose value differences within a class of property which are offset at the end of the reconciliation process of an audit, resulting in a net total value for each class of property. Thus, the "result of an audit" within the meaning of section 469 is the net total value for each class of property. Staff further recommends that, for purposes of the proposed rule, *class of property* should be defined to mean those classes used in the original assessment; for example (1) personal property, (2) improvements, and (3) land. Since only the net total value per class of property is shown on an assessment roll each year, this procedure will be compatible with existing computer systems used throughout the county assessors', county auditors', and county tax collectors' offices.

FORMAL ISSUE PAPER

To ensure that escape assessments of individual classes of property are properly recognized for purposes of appeal, staff recommends that the proposed rule specifically state that an assessor is not permitted to offset overassessments and underassessments between classes of property—personal property, improvements, and land—in a single year, and is not permitted to offset differences in the net total value of all property for each year between years covered by the audit.

Staff's recommendation is consistent with the mass appraisal methods used to appraise business property. The property at a given location is described legally by one parcel number and each class is given one roll value, even though there may actually be many individual pieces of personal property being assessed at the location. If offsetting underassessments and overassessments of individual pieces or categories of property within a particular class of property result in no value difference or an overvaluation compared with the original assessment, then the result of the audit has not disclosed property subject to escape assessment.

In addition, paragraph two of section 469 states:

Upon completion of an audit of the taxpayer's books and records, the taxpayer shall be given the assessor's findings in writing with respect to data that would alter any previously enrolled assessment.

This provision lends further support to the view that the Legislature intended that the audit result that trigger the section 469 equalization provisions were those that, upon completion, "would alter any previously enrolled assessment." Since only the net result of an audit and assessment for each year is enrolled for each class of property, only a value difference disclosing an escape assessment in the net value for each class of property would "alter any previously enrolled assessment."

Article 4, beginning with section 531, contains the provisions pertaining to property escaping assessment. Each of the sections within this article contemplate that an escape assessment causes a change to the assessment roll—not that an escape assessment includes discrepancies within a class of property disclosed during individual stages of an audit that resulted from errors in the self-reported cost provided by the taxpayer on the property statement.

B. Pros of the Staff Recommendation

This recommendation is consistent with the intent of section 469 which is to ensure that value is correctly allocated among all classes of property within the appraisal unit. When the appraisal unit is originally assessed, the value of each class of property is assessed and the total value of those assessments is enrolled. If the assessee is satisfied with the total value for all property, then no appeal is filed. Subsequently, if the result of an audit discloses that one class of property is underassessed and subject to escape assessment, the total value of the property will then be increased. Thus, the assessee should have the opportunity to appeal all classes of property in order to ensure that the value for the entire appraisal unit is correct.

C. Cons of the Staff Recommendation

- The equalization provisions of section 469 permit an assessee to appeal all of his/her property at the location where the result of an audit discloses property subject to escape assessment. Consequently, if the audit discloses that any property, even individual items of property within a class of property, was underassessed or not assessed, then the assessee has the right to appeal all property. Staff's recommendation excessively restricts the plain language of the statute by limiting an assessee's right to use the equalization provisions in section 469 to the circumstances in which

FORMAL ISSUE PAPER

the net total per class of property shows an escape assessment; the assessee could not use the equalization provisions when a discrepancy is discovered on a single piece of property during one stage of the audit. As a result, the taxpayer will not be entitled to equalization on the entire property simply because escaped property is discovered, but rather only when the result of the audit reveals a net escape assessment on a class of property. (*California Taxpayers' Association's contention*)

- Staff's recommendation is invalid because it conflicts with section 534 of the Revenue and Taxation Code by expanding an assessee's right to appeal escape assessments in a manner not authorized by that statute. Sections 534 and 1605 provide that an escape assessment is not effective for any purpose, including review, equalization and adjustment, until the assessee has been notified. Hence, an appeals board has no authority to hear an application appealing an escape assessment if the assessor has not sent a notice of escape assessment. In many instances, for audits conducted pursuant to section 469, no notice of escape assessment is issued because escape assessments are offset by overassessments of other classes of property resulting in no change to the assessment or a refund. However, the staff recommendation would allow an assessee to appeal escape assessments of individual classes of property regardless of whether a notice of escape assessment has been issued. (*Some County Assessors' and County Counsels' contention*)

D. Statutory or Regulatory Change

Action by the Board to adopt a Property Tax Rule interpreting the equalization provisions of section 469 will add section 305.3 to Title 18 of the California Code of Regulations, Subchapter 3.

E. Administrative Impact

None

F. Fiscal Impact**1. Cost Impact**

None

2. Revenue Impact

None

G. Taxpayer/Customer Impact

Adoption of a Property Tax Rule interpreting the equalization provisions of section 469 will affect administrative procedures for the assessment appeals process at the county level and the functions of the clerks of the appeals boards, appeals board members, county assessors, county counsels, and each taxpayer seeking a reduction in assessment of his or her property's value following an audit conducted pursuant to section 469.

H. Critical Time Frames

There is no critical time frame for adoption of a Property Tax Rule interpreting section 469 since a county assessor conducts audits pursuant to section 469 on an ongoing basis. The 60-day period for filing an application appealing the result of an audit disclosing property subject to an escape assessment commences on receipt of the proper notice of the escape assessment. Consequently, the

equalization provisions of section 469 provide for the filing of an application for an equalization hearing before a local board of equalization or county assessment appeals board throughout the year.

VI. Alternative 1

A. Description of the Alternative 1 (California Taxpayers' Association proposal)

The language means a determination that any individual item of property was underassessed or not assessed at all. This alternative would provide that the equalization provisions in section 469 are triggered when the audit shows any escaped value difference, regardless of whether that difference is offset and the net result of the assessment of the class of property is a refund or no change to the roll. The phrase "result of an audit" should be defined as "information obtained and conclusions reached by the audit during the audit process."

When the Legislature enacted section 469 and 1605(e), it could have chosen to make actual enrollment of an escape assessment necessary to trigger a taxpayer's appeal rights. Instead, the Legislature chose to make the audit disclosure of property subject to escape assessment the jurisdictional prerequisite and the legislative counsel digest to A.B. 1643, legislation proposed by the assessors in 1999, specifically recognized this distinction.

The phrase "result of an audit" does not appear to be defined anywhere in the property tax portions of the Revenue and Taxation Code, and is a very ambiguous term. "Result of an audit" certainly is not synonymous with issuance of an escape assessment. Perhaps "result of an audit" is intended simply to imply somehow that the disclosure (of property subject to escape assessment) results during or from the audit.

Moreover, while section 1605(e) and section 469 both use the phrase "discloses property subject to an escape assessment," indicating that the legislature wanted to stress the importance of those words, the same cannot be said about the "result of the audit" phrase. It appears in the fourth paragraph of section 469, but is left out of section 1605(e) altogether. The fifth paragraph of section 469 also refers to what the "audit for any particular year discloses," rather than to what the *result* of the audit discloses. Thus, it seems problematic to place much emphasis or significance on the "result of the audit" term. The more important term in sections 469 and 1605(e) is clearly the trigger phrase "audit for any year discloses property subject to escape assessment."

For section 469 purposes, it is important for the Committee to recognize that the assessor should not be able simply to ignore information obtained from the taxpayer during the audit and decline to find over- and underassessments which would result from such information. This is critical where the assessor's actions or inaction after receiving such information may impair or block completely the taxpayer's appeal rights.

B. Pros of the Alternative 1

It would afford a taxpayer the right to appeal the assessment of all of its property for past years, parallel to the assessor's right to audit all the taxpayer's property, whenever an audit disclosed that an individual item of property had been underassessed or not assessed at all.

C. Cons of the Alternative 1

- It is not consistent with the intent of section 469 which is to ensure that value is correctly allocated among all classes of property within the appraisal unit. The equalization provisions are intended to provide the assessee with an opportunity to appeal all classes of property in order to ensure that the value for the entire appraisal unit is correct. The alternative would allow an appeal

FORMAL ISSUE PAPER

even if there were no change or an overassessment of a class of property. Such a finding would have no effect on the overall value of the appraisal unit and no effect on the value allocation.

When it added paragraph two to section 469, the Legislature intended that the audit results that trigger the section 469 equalization provisions were those that, upon completion, "would alter any previously enrolled assessment." Since only the net result of an audit and assessment is enrolled for each class of property, only a value difference disclosing an escape assessment in the net result for each class of property could "alter any previously enrolled assessment."

(Staff's contention)

- Sections 534 and 1605 provide that an escape assessment is not valid until the assessee has been notified. However, there is no notification requirement when a value discrepancy for an individual piece of property is disclosed in a preliminary stage of an audit. Rather, an assessee must be notified of the results of an audit that indicate an escape assessment, that is, the net total value of all classes of property that results in a change to the assessment roll. If the proponents of Alternative 1 propose that an assessor must send a notice of such value discrepancies, then the rule would create a state mandate in Property Tax Rule 305.3 by requiring the county assessor to send a notice not otherwise required by law. *(Some County Assessors' and County Counsel's contention)*

D. Statutory or Regulatory Change

Action by the Board to adopt a Property Tax Rule interpreting the equalization provisions of section 469 will add section 305.3 to Title 18 of the California Code of Regulations, Subchapter 3.

E. Administrative Impact

None

F. Fiscal Impact

None

1. Cost Impact

None

2. Revenue Impact

None

G. Taxpayer/Customer Impact

Adoption of a Property Tax Rule interpreting the equalization provisions of section 469 will affect administrative procedures for the assessment appeals process at the county level and the functions of the clerks of the appeals boards, appeals board members, county assessors, county counsels, and each taxpayer seeking a reduction in assessment of his or her property's value following an audit conducted pursuant to section 469.

This alternative would create a state mandate in Property Tax Rule 305.3 by requiring the county assessor to send a notification of discrepancies discovered during preliminary stages of an audit.

H. Critical Time Frames

There is no critical time frame for adoption of a Property Tax Rule interpreting section 469 since a county assessor conducts audits pursuant to section 469 on an ongoing basis. The 60-day period for filing an application appealing the result of an audit disclosing property subject to an escape assessment commences on receipt of the proper notice of the escape assessment. Consequently, the equalization provisions of section 469 provide for the filing of an application for an equalization hearing before a local board of equalization or county assessment appeals board throughout the year.

VII. Alternative 2

A. Description of the Alternative 2 (Some County Assessors' and County Counsels' proposal)

The language means a determination that the net total value of all classes of property for all years of the audit was underassessed. Property Tax Rule 305.3 would specify that the net total values for each class of property subject to an audit should be offset against each other to find "the result of an audit," i.e., the net total value of all the property. For purposes of this regulation, *class of property* would be defined to mean those classes used in the original assessment; for example (1) personal property, (2) improvements, and (3) land.

As an example of the application of this alternative, an audit could result in an underassessment of fixtures and an overassessment of personal property that exactly offset, making "the result of an audit" no change to the roll. Or, an audit could result in an underassessment of fixtures and greater overassessment in personal property, making "the result of an audit" a refund.

B. Pros of the Alternative 2

This alternative fulfills the intent and purpose of the equalization provisions by allowing an assessee to appeal only if the final total value determination disclosed an escape assessment and, thereby, increased the assessed value of the entire appraisal unit. In that event, an assessee should have the right to appeal the value of all property to ensure the value has been properly allocated.

C. Cons of the Alternative 2

This alternative would bar an assessee's right to appeal when the result of an audit discloses property subject to escape assessment because the equalization provisions in section 469 would not apply except where the net total value of all property shows an escape assessment.

D. Statutory or Regulatory Change

Action by the Board to adopt a Property Tax Rule interpreting the equalization provisions of section 469 will add section 305.3 to Title 18 of the California Code of Regulations, Subchapter 3.

E. Administrative Impact

None

F. Fiscal Impact

1. Cost Impact

None

2. Revenue Impact

None

G. Taxpayer/Customer Impact

Adoption of a Property Tax Rule interpreting the equalization provisions of section 469 will affect administrative procedures for the assessment appeals process at the county level and the functions of the clerks of the appeals boards, appeals board members, county assessors, county counsels, and each taxpayer seeking a reduction in assessment of his or her property's value following an audit conducted pursuant to section 469.

H. Critical Time Frames

There is no critical time frame for adoption of a Property Tax Rule interpreting section 469 since a county assessor conducts audits pursuant to section 469 on an ongoing basis. The 60-day period for filing an application appealing the result of an audit disclosing property subject to an escape assessment commences on receipt of the proper notice of the escape assessment. Consequently, the equalization provisions of section 469 provide for the filing of an application for an equalization hearing before a local board of equalization or county assessment appeals board throughout the year.

Prepared by: Property Taxes Department; Policy, Planning, and Standards Division
Legal Division; Property Taxes Section

Current as of: October 12, 2000